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USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/LMOGHTADER
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SUBJECT: Economic Briefing for March 2006
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11. This cable summarizes selected recent economic events in Taiwan in March 2006:

- Economy clouded by card debt, fuel costs
- Capital outflows continue
- Credit/cash card debt hurts banks profits
- Tightened control of cross-Straits trade
- Corning locates largest R&D center in Taiwan
- DuPont joins fire retardant closing market from Taiwan
- Taiwan sets up first solar cell testing center
- Taiwan machine tool exports
- High infotech ranking

Taiwan's Economy Clouded by Card Debt and Fuel Costs

12. Taiwan's positive economic performance in the second half of last year has continued into Q1 this year. Export growth on a year-on-year basis in the first two months remained at the Q4 2005 level of 14%, rising from 7% in Q3 last year. Industrial growth January-February also reached the Q4 2005 level of 9%, (compared to below 5% in Q3 2005). Inflation of 1.88% and unemployment of 2.86% were lower than 2005 rates. Consequently, local think tanks estimate Taiwan's Q1 2006 economic growth well above 4%, with the Statistical Bureau estimating a rate of 5.1%.

13. Taiwan's export growth will continue in Q2 as export orders (to which shipments will be made in three to six months) grew 22% in January-February. However, the government's recent measures to

address delinquent credit/cash card debt have caused concern about contraction of consumer lending which may dampen private consumption and drag economic growth. Another negative factor for Taiwan's economy is higher energy prices, which have contributed to a 120% year-on-year increase in the cost of crude oil imports in the first two months this year.

Capital Outflow Erodes Taiwan's BOP Status

¶4. Taiwan in 2005 had a trade surplus of US\$18 billion, which more than offset its services trade deficit and net capital outflow, and which pushed up Taiwan's foreign exchange (FX) reserves by 4.8% to US\$253 billion. An export boom late last year contributed to an 11.5% expansion in Taiwan's 2005 trade surplus. However, foreign investors' repatriation of earnings doubled and higher interest rates overseas prompted the outflow of local capital to surge 51%. These factors offset a large part of the trade sector's contribution to the balance of payments (BOP) and resulted in a 24.5% decline of Taiwan's 2005 overall balance to US\$20 billion. The 2005 surplus would have dropped to US\$10.5 billion if the central bank had not made repurchase agreements to meet growing FX demand. Without the CBC repurchase agreements, Taiwan BOP would have been in deficit in Q2 last year, and the deficit would have increased from US\$300 million in Q2 to US\$3.1 billion in Q3 and US\$1.1 billion in Q4.

Card Debt Response Impacts Banks

¶5. Media and legislative pressure has forced Taiwan regulators to adopt a series of measures this month to protect consumers from debt: Banks may not issue credit/cash cards to teenagers and must set a strict credit limit for students. Banks may not use

sensational credit/cash card advertisements, and must waive interest on card debt if rescheduling negotiations start before April 10. Harassing and violent debt collection methods are banned, as are new debt collection firms. The legislature is still considering an interest rate cap and personal bankruptcy bills. In response, several banks have stopped issuing credit/cash cards, and some have even shut down their card departments.

Regulation of Cross-Strait Economic Exchanges Increased

¶6. In his New Year Statement delivered on January 1, Chen Shui-bian announced a policy of "active management, effective opening" towards cross-Strait economic exchanges. The Executive Yuan (EY) promulgated a set implementation measures on March 22. The measures will tighten regulations covering travel of PRC nationals to Taiwan, agricultural exports to China, large investments in China, and capital flows to China.

¶7. Specifically, Taiwan will ban entry of tourists from the PRC's Fujian, Hebei, and Guangdong provinces (large numbers of tourists from these provinces end-up staying permanently); double the return guaranty the Taiwan tourist agency must deposit (from NT\$1 million to NT\$2 million); and require the Taiwan Tourist Agent Association to set stricter regulations for their members. Taiwan will crackdown on agricultural smuggling into Taiwan by doubling the award for information and requiring coastal fishing boats to install vessel monitor systems. Taiwan will increase its monitoring of agricultural exports to China and forbid PRC crewmembers from working on small fishing and entertaining vessels. Projects with an investment exceeding US\$20 million will be subject to "policy" screening and post-investment follow-up, in addition to normal review by the Foreign Investment Commission. The screening process will cover financial management plans, technology transfers, equipment exports, and counter investment in Taiwan. Taiwan will increase the frequency of examinations of over financial firms' subsidiaries, branches and representative offices in Hong Kong and China. Taiwan banks' offshore banking units (OBU), subsidiaries, and branches are required to closely monitor their lending to business firms in China, and make regular reports to regulators. (For more details, see reftel.)

Corning opens major R&D center at ITRI

¶18. Corning established its largest research and development center in Asia at Taiwan's Industrial Technology Research Institute (ITRI) in mid March. Corning will use the center chiefly to develop technologies of glass substrate for liquid crystal displays (LCD), one of the backbones of Taiwan's industrial sector. In the future, the center will research fuel cells, biophotonics, optical fiber and semiconductors. This new center in ITRI is Corning's fifth in the world. Its four other R&D centers are located in the United States, France, Russia and Japan. Corning selected Taiwan for its largest R&D center in Asia because of major investments here including LCD glass substrate facilities in both the Southern Taiwan Science Park in Tainan and the Central Taiwan Science Park in Taichung. In January, Corning officially opened its Taichung plant, the company's largest investment in a single production facility in the world with a construction cost of USD 1.5 billion.

Dupont's Fire Retardant Clothing Project

¶19. DuPont has begun cooperating with Formosa Taffeta to use DuPont's Nomex fibers for manufacture of fire-retardant clothing. This project marks DuPont's first move from manufacturing and marketing of Nomex into the Nomex fabric and clothing market. With its eyes on Taiwan's massive petrochemical industry, DuPont sees a big potential fire-resistant protective clothing market in Taiwan. Formosa Petrochemical Corporation and Taiwan Power Company are the two largest users of Nomex-made protective wear in Taiwan. Formosa Petrochemical alone accounts for about 80% of the total demand. One Nomex fire-resistant suit cost about NTD 4,500. DuPont's Nomex fibers, on the market for over thirty years, have been used to make heat- and flame-resistant clothing for firefighting, auto racing and electricity generation. Nomex fibers are also used for electrical insulation.

Taiwan's First Solar Cell Testing Center

¶10. With solar cells set to be one of the next major industries in Taiwan, Taiwan's Industrial Technology Research Institute signed on March 14 a cooperation contract with TV Rheinland Group of Germany for establishing Taiwan's first photovoltaic module testing laboratory. The laboratory will speed up delivery of solar products to foreign buyers by testing and certifying the products locally. The production value of Taiwan's solar industry in 2005 totaled NTD 7 billion of which solar cells accounted for NTD 5.4 billion. The global production value of the solar sector in 2010 is expected to reach NTD 230 billion of which Taiwan is expected to contribute NTD 14 billion.

Taiwan's Machine Tool Exports

¶11. In 2005, Taiwan's machine tool exports increased 18 percent to reach a total value of US\$2.7 billion. Taiwan is the world's fourth largest machine tool exporter, after Japan, Germany and Italy. Exports of metal-cutting machines, including machining centers and lathes, during the year increased by 18.5 percent while exports of metal-forming machine tools was up 17.2 percent. Hong Kong and Mainland China together took 41 percent or US\$1.1 billion of Taiwan's total machine tool exports. The U.S. was the second biggest export market with shipment of US\$260 million. Other major markets included: Turkey, Thailand, South Korea, Netherlands, Malaysia, and the U.K. Vice President Wang Cheng-ching of the Taiwan Association of Machinery Industries (TAMI) predicts that production and exports of machine tools will enjoy 10 percent growth in 2006.

Taiwan An Information Age Leader

¶12. Taiwan was ranked seventh out of 115 world economies in terms of its information and technology developments, according to the Global Information Technology Report 2005-2006 Network Readiness Index rankings. Among Asian economies, Taiwan was ranked higher than Japan and Hong Kong, and was second to Singapore.

